No. 16395

In the United States Court of Appeals for the Ninth Circuit

Commissioner of Internal Revenue, petitioner

v.

J. I. Morgan and Frances Morgan, respondents

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE PETITIONER

Charles K. Rice,
Assistant Attorney General.

Lee A. Jackson,
I. Henry Kutz,
Joseph Kovner,
Attorneys,
Department of Justice,
Washington 25, D. C.

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INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	4
Statement of points to be urged	7
Summary of Argument	8
Argument:	
The Tax Court erred in holding that the annual increments in cash value of certificates of indebtedness were not taxable as interest income at ordinary rates	9
A. The annual increases in the excess of cash value over the amounts paid in during the taxable years represent interest taxable as ordinary income accruing each year	9
B. Ordinary interest income is not converted into capital gain by a sale or exchange	10
C. Section 117(f) of the 1939 Code is not a directive that amounts received upon retirement of an evidence of indebtedness, which represent accrued ordinary interest income, shall be converted into capital gain, or that the right to receive the ordinary income shall be treated differently than upon the sale of a capital asset together with the right to receive ordinary income	13
Conclusion	21

CITATIONS

Cases:

Automobile Club v. *Commissioner*, 353 U. S. 180	18
Caulkins v. *Commissioner*, 1 T. C. 656, affirmed, 144 F. 2d 482	7, 9, 17, 18, 19, 20
Commissioner v. *P. G. Lake, Inc.*, 356 U. S. 260	10
Dally v. *Commissioner*, 227 F. 2d 724	18
Deputy v. *Dupont*, 308 U. S. 488	9

Cases—Continued Page

Doyle v. *Commissioner,* 147 F. 2d 769 10
Fairbanks v. *United States,* 95 F. 2d 795, affirmed, 306 U. S. 436 16
Fisher v. *Commissioner,* 209 F. 2d 513, certiorari denied, 347 U. S. 1014 .... 9, 10, 11, 17
Helvering v. *Horst,* 311 U. S. 112 10
Helvering v. *Smith,* 90 F. 2d 590 10
Hort v. *Commissioner,* 313 U. S. 28 10
Lasky v. *Commissioner,* 22 T. C. 13, appeal dismissed, 235 F. 2d 97, affirmed, 352 U. S. 1027 10
Old Colony R. Co. v. *Commissioner,* 284 U. S. 552 9
Paine v. *Commissioner,* 23 T. C. 391, reversed, 236 F. 2d 398 .... 10, 18
Rhodes' Estate v. *Commissioner,* 131 F. 2d 50 10
Security Mills Co. v. *Commissioner,* 321 U. S. 281 18
Shattuck v. *Commissioner,* 25 T. C. 416 .... 10, 18
Tobey v. *Commissioner,* 26 T. C. 610 18
Trousdale v. *Commissioner,* 219 F. 2d 563 10
Tunnell v. *United States,* 259 F. 2d 916 .... 10, 12
United States v. *Snow,* 223 F. 2d 103 .... 10, 17

Statutes:

Internal Revenue Code of 1939:
Sec. 22 (26 U. S. C. 1952 ed., Sec. 22) 2
Sec. 117 (26 U. S. C. 1952 ed., Sec. 117) 3
Internal Revenue Code of 1954, Sec. 1232 (26 U. S. C. 1952 ed., Supp. II, Sec. 1232) 4

Miscellaneous:

H. Rep. No. 704, 73d Cong., 2d Sess., p. 31 (1939-1 Cum. Bull. (Part 2) 554, 557) 15
House Hearings, Revenue Act of 1934, pp. 179-181, 191 15
Rev. Rul. 119, 1953-2 Cum. Bull. 95 18
Rev. Rul. 55-136, 1955-1 Cum. Bull. 213 18
Rev. Rul. 56-299, 1956-1 Cum. Bull. 603 18
S. Rep. No. 1622, 83d Cong., 2d Sess., p. 433 (3 U. S. C. Cong. & Adm. News (1954) 4621, 5076) 19, 20
3B Mertens, Law of Federal Income Taxation (Rev.):
Sec. 22.40 .... 10, 18, 19
Sec. 22.94 10

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

J. I. MORGAN AND FRANCES MORGAN, RESPONDENTS

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BRIEF FOR THE PETITIONER

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 5-35) are reported at 30 T.C. 881.

JURISDICTION

The petition for review (R. 50-57) involves federal income tax for the years 1950, 1951, 1952, 1953 and 1954. On December 22, 1955, the Commissioner of Internal Revenue issued a notice of deficiency. (R. 37.) Within ninety days thereafter and on March 12, 1956, the taxpayers filed a petition with

the Tax Court for a redetermination of the deficiency under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3.) The decision of the Tax Court was entered September 23, 1958. (R. 49.) The case is brought to this Court by petition for review filed December 11, 1958. (R. 57.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether, as the Commissioner contends, the annual interest increment in cash value of an "accumulative investment certificate" owned by taxpayer reporting income on an accrual basis is taxable as ordinary income each year or whether, as the Tax Court held, Section 117(f) of the 1939 Code and Section 1232(a)(1) of the 1954 Code require that the interest increment in the cash value be taxable only as capital gains upon retirement of the certificate at maturity.

STATUTES INVOLVED

Internal Revenue Code of 1939:

Sec. 22. Gross Income.

(a) [as amended by Section 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of

any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 117 [As amended by Section 150(a)(1) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Section 322(c)(2) of the Revenue Act of 1951, c. 521, 65 Stat. 452]. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

* * * *

(4) *Long-term capital gain.* — The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income;

* * * *

(f) *Retirement of Bonds, Etc.*—For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in

registered form, shall be considered as amounts received in exchange therefor.

*   *   *   *

(26 U.S.C. 1952 ed., Sec. 117.)

Internal Revenue Code of 1954:

SEC. 1232. BONDS AND OTHER EVIDENCES OF INDEBTEDNESS.

(a) *General Rule.*—For purposes of this subtitle, in the case of bonds, debentures, notes or certificates or other evidences of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or government or political subdivision thereof—

(1) *Retirement.*—Amounts received by the holder on retirement of such bonds or other evidences of indebtedness shall be considered as amounts received in exchange therefor (except that in the case of bonds or other evidences of indebtedness issued before January 1, 1955, this paragraph shall apply only to those issued with interest coupons or in registered form, or to those in such form on March 1, 1954).

*   *   *   *

(26 U.S.C. 1952 ed., Supp. II, Sec. 1232.)

STATEMENT

This appeal is concerned with only one of the issues decided by the Tax Court. (Issue 5, R. 29-32.) The facts with regard to this single issue are not in dispute and can be stated in full as found by the Tax Court as follows:

On or about August 10, 1937, taxpayer, J. I. Morgan, acquired an "Accumulative Investment Certificate," Series F-232668, from Investors Syndicate (presently known as Investors Diversified Services, Inc.) of Minneapolis, Minnesota. Under the terms of the certificate, the issuing company agreed to pay to Morgan (with certain options) at the expiration of 15 years, an amount in excess of his aggregate payments. On September 28, 1952, J. I. Morgan exercised one of the available options to extend the certificate for an additional period of not more than 10 years. (R. 29.)

The following is a detailed statement of the foregoing "Accumulative Investment Certificate" (R. 30):

INVESTORS SYNDICATE

Minneapolis, Minnesota

Name Changed on 3-30-49 to: Investors Diversified Services, Inc.

Number—Series F232668

Dated 8-10-37

Annual Advance Payment for 15 years $600.00

Maturity in 15 years (option 13 elected 9-28-52 to continue not more than 10 years).

With optional settlement privileges.

Cash Value for each $25.00 [1] Maturity	Year	To	Cash Value end of year	Paid in	Excess of Cash Value over amounts Paid in	Yearly Increase
$ 44	1		$ 220	$ 600		
134	2		670	1,200		
264	3		1,320	1,800		
400	4		2,000	2,400		
540	5		2,700	3,000		
700	6		3,500	3,600		
860	7		4,300	4,200		
1,024	8		5,120	4,800		
1,200	9		6,000	5,400		
1,418	10	8-10-47	7,090	6,000		
1,600	11	8-10-48	8,000	6,600		
1,810	12	8-10-49	9,050	7,200	$1,850	
2,020	13	8-10-50	10,100	7,800	2,300	$450
2,240	14	8-10-51	11,200	8,400	2,800	500
2,500	15	8-10-52	12,500	9,000	3,500	700
2,724	16	8-10-53	13,620	9,600	4,020	520
2,958	17	8-10-54	14,790	10,200	4,590	570

[1] While it is not material in any way, it should be noted that the heading of the first left-hand column should be "cash value for each $2,500 maturity," in place of "$25.00 maturity."

Taxpayer kept his books and prepared his tax returns on the accrual basis. (R. 7.)

On these facts, the Commissioner contended that the amounts of annual cash increment of $450, $500, $700, $520 and $570 for the years 1950 through 1954, respectively, were taxable as ordinary interest income under Section 22(a) of the 1939 Code and Section 61(a)(4) of the 1954 Code. The Tax Court, relying wholly upon the authority of its prior decision in *Caulkins* v. *Commissioner*, 1 T.C. 656, affirmed by the Sixth Circuit Court of Appeals, 144 F. 2d 482, rejected this contention and held that the annual increments in cash value should be reported as capital gain upon retirement at maturity under Section 117(f) of the 1939 Code and Section 1232 (a)(1) of the 1954 Code rather than as ordinary interest income accrued during the years of increase. (R. 31-32.)

STATEMENT OF POINTS TO BE URGED

1. The Tax Court erred in holding that the annual increments during the tax years in the cash value of an "Accumulative Investment Certificate," owned by the taxpayer-husband, was taxable as capital gain upon retirement of the "Certificate" at maturity, under Section 117(f) of the Internal Revenue Code of 1939 and Section 1232(a)(1) of the Internal Revenue Code of 1954.

2. The Tax Court erred in failing to hold that the annual increments in cash value of the "Certificate" were taxable in the years of increment as interest

income to the taxpayers, who kept their books and filed their income tax returns on the accrual basis.

SUMMARY OF ARGUMENT

The taxpayer here has a right to an annual increment in the cash value of his investment. This increment is ordinary interest income. The taxpayer contends that it must be treated as capital gain by virtue of Section 117(f) of the 1939 Internal Revenue Code and its cognate in the 1954 Code, Section 1232(a)(1), applicable in the year 1954. It is settled, however, that ordinary income cannot be converted into capital gain by any sale or exchange of the right to the income, either separately or in conjunction with the property producing the income. Section 117(f) does not alter this rule; it was enacted in order that gain on the retirement of bonds which would have been taxable as capital gain on a sale or exchange would similarly be taxed as capital gain. Section 117(f) simply provides that a retirement shall be treated the same as an exchange. The section does not require that all of the proceeds received upon retirement of bonds shall be treated as capital gain or otherwise convert ordinary income into capital gain which would not have been taxed as capital gain upon a sale or exchange. The decision of the Sixth Circuit, upon which the taxpayer relies, misconstrues Section 117(f), is contrary to principle and, it is respectfully submitted, should not be followed.

ARGUMENT

The Tax Court Erred in Holding That the Annual Increments in Cash Value of Certificates of Indebtedness Were Not Taxable as Interest Income at Ordinary Rates

A. *The annual increases in the excess of cash value over the amounts paid in during the taxable years represent interest taxable as ordinary income accruing each year*

Taxpayer purchased by annual installments of $600 a 15-year accumulative investment certificate which was extended by exercise of his option in 1952 for an additional period to continue not more than 10 years. (R. 29-30.) As already stated, during each of the taxable years 1950-1954, inclusive, there was an annual increase in the excess of the cash value of the certificate over the amounts paid in. (R. 30-31.) This increment in value of the certificate plainly constitutes compensation for the use of taxpayer's money and thus, it is well settled, is interest. The fact that the contract does not provide for equal amounts of interest to be set aside each year, available to the holder, does not affect the question. The increment is consideration paid for the use of the amounts paid in. *Deputy* v. *Dupont*, 308 U.S. 488, 497; *Old Colony R. Co.* v. *Commissioner*, 284 U.S. 552, 560-561; *Fisher* v. *Commissioner*, 209 F. 2d 513 (C.A. 6th), certiorari denied, 347 U.S. 1014; *Caulkins* v. *Commissioner*, 1 T.C. 656, affirmed, 144 F. 2d 482, 484 (C.A. 6th). Income from interest is, of course, taxable as ordinary income under Section 22(a) of the 1939 Code, *supra*,

and its cognate for 1954, Section 61(a)(4) of the 1954 Code (26 U.S.C., Supp. II, Sec. 61).

B. *Ordinary interest income is not converted into capital gain by a sale or exchange*

It is established that ordinary income cannot be converted into capital gain by any sale or exchange of the right to the income, either separately or in conjunction with the property producing the income. *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260; *Hort* v. *Commissioner*, 313 U.S. 28; *Helvering* v. *Horst*, 311 U.S. 112; *Tunnell* v. *United States*, 259 F. 2d 916 (C.A. 3d); *United States* v. *Snow*, 223 F. 2d 103 (C.A. 9th); *Trousdale* v. *Commissioner*, 219 F. 2d 563 (C.A. 9th); *Fisher* v. *Commissioner*, *supra; Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C.A. 6th); *Doyle* v. *Commissioner*, 147 F. 2d 769 (C.A. 4th); *Helvering* v. *Smith*, 90 F. 2d 590 (C.A. 2d); *Shattuck* v. *Commissioner*, 25 T.C. 416; *Paine* v. *Commissioner*, 23 T.C. 391, reversed on other grounds, 236 F. 2d 398 (C.A. 8th); *Lasky* v. *Commissioner*, 22 T.C. 13, appeal dismissed, 235 F. 2d 97 (C.A. 9th), affirmed, 352 U.S. 1027; 3 B Mertens, Law of Federal Income Taxation (Rev.) secs. 22.40, 22.94.

The rule is fully stated by this Court in *Snow* and by the Sixth Circuit in *Fisher*. In *Snow*, the taxpayer sold his interest in a partnership, including his share of undistributed earnings. This Court rejected his claim for capital gains treatment of the entire gain on the sale, and held that the portion of the amount received from the sale equal to the taxpayer's share of undistributed earnings was taxable

as ordinary income. The opinion summarizes the settled rule and also sets forth the application of the rule by the Sixth Circuit in the *Fisher* case, as follows (pp. 108-109):

> It is a fundamental principle of federal tax law that you must regard any ordinary income derived from an income-producing capital asset as ordinary income. Consequently, the assignment of accrued ordinary income must be treated separately from the assignment of the capital asset which produced the income. This is not an exception to the rule that capital assets held for more than six months shall be given capital gains tax treatment. It is only when a capital asset appreciates in value and is subsequently sold, beyond the six months' period, that the gain realized may be given capital gains tax treatment under Section 117 of the Internal Revenue Code.
>
> The general rule is that a right to receive ordinary income, produced by a capital asset, is not transmuted into a capital asset by the sale or assignment of the capital asset together with the right to receive the ordinary income. We believe that the statutory provisions referred to above dealing with the taxation of partner's income control the disposition of this case. In addition, we see no logical reason why ordinary income from an interest in a partnership should receive different tax treatment than income from any other capital asset.

Fisher v. *Commissioner*, 6 Cir., 209 F. 2d 513, certiorari denied 1954, 347 U.S. 1014, 74 S. Ct. 868, 98 L. Ed. 1136, involved a bona fide sale of notes held for more than six months for a

greater sum than their face value, since the sale price of the notes was made to reflect the interest due thereon. The taxpayer treated the entire transfer as that of an indivisible sale of a capital asset. The court of appeals affirmed the Tax Court, 19 T.C. 384, in holding that the taxpayer must treat his right to ordinary income (interest due on the notes) as ordinary income and not capital gain and that in a tax sense it was unimportant that the interest due on the notes (ordinary income) was later collected by the purchaser of the capital asset (notes) rather than being paid to the seller of the notes, since the purchaser of the capital asset in effect paid the interest to the taxpayer when he paid more for the notes than their face value.

In the Fisher case the court pointed out that the fundamental error of the taxpayer was his failure to recognize that gain realized upon the sale of a capital asset which has appreciated in value is capital gain; whereas, gain realized by way of income from the capital asset is ordinary income.

* * * *

The same view has been expressed by the Court of Appeals for the Third Circuit in *Tunnell* v. *United States*, *supra*, where it was stated (p. 919):

> The payment of the purchase price, for which a part of the *quid pro quo* was taxpayer's right to receive this income, was as to that part essentially a substitute for what would otherwise be received at a future time as ordinary income. And as to that part, it was not appreciation in value of the capital asset, which would be capital

gain, but income produced by the capital asset, which is ordinary income.

It is thus apparent that if the taxpayer here had sold or exchanged the investment certificates, the portion of the amount received representing the yearly increments in cash value over the amounts paid in would be taxable as ordinary income. In other words, there would be no capital gain, until the sale or exchange price was in excess of the cash value of the policy or installments paid in, whichever was the higher.[2]

C. *Section 117(f) of the 1939 Code is not a directive that amounts received upon retirement of an evidence of indebtedness, which represent accrued ordinary interest income, shall be converted into capital gain, or that the right to receive the ordinary income shall be treated differently than upon the sale of a capital asset together with the right to receive ordinary income.*

Taxpayer contended below that the annual increment in the cash value of a certificate, such as is here involved, is not properly taxable during the years of increase, but is taxable only upon retirement at maturity as capital gain under Section 117(f) of the 1939 Code,[3] *supra.* We contend, however, that this

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[2] Until the sixth year, the amounts paid in or cost exceeded cash value.

[3] Section 1232(a)(1) of the 1954 Code, *supra,* is applicable to the taxable year 1954 only. Since this provision is, so far as here relevant substantially identical with Section 117(f) of the 1939 Code, in the discussion only Section 117(f) will usually be referred to and comments made with respect to it are to be deemed also applicable to the cited 1954 Code section.

increment is taxable as ordinary interest income and, hence, since taxpayer is on the accrual basis, was taxable to him in the respective years in which it accrued. Indeed, the case of accrual taxpayers emphasizes the fallacy in construing Section 117(f) as intending to convert amounts received on account of ordinary income into capital gain. Thus, contemporaneous with the years during which interest accrues, it is not possible to determine whether the certificate will be retired or whether it will be sold or exchanged on or before maturity. As demonstrated in the proceeding Subpoint "B", if it is sold or exchanged, the right to receive the ordinary interest income is not transmuted into a capital gain by the sale or exchange of the capital amount together with the right to receive the ordinary income. But, if the Tax Court is here correct, should the certificate be retired, this right to ordinary income is taxed at capital rates. Hence, whether the interest accrues as income in the case of an accrual taxpayer during the respective years in which he obtains the right to it, will not be determinable—if the Tax Court's construction of Section 117(f) is correct—until years later when it is ascertainable whether the certificate or other evidence of indebtedness is on the one hand sold or is on the other hand retired. It seems highly unlikely that this remarkable result actually represents a correct interpretation of the intent of Congress. This lends support to the view that the Tax Court's construction of Section 117(f) is erroneous and that, in accordance with the settled rule, the interest increment entered into the income

of this accrual taxpayer as ordinary income in the course of each of the taxable years when his right to receive it inured and was complete.

On its face, Section 117(f) simply changed the prior law to provide that amounts received on retirement of corporate bonds and similar evidences of indebtednesses shall be treated the same as amounts received on an exchange of the bonds. It does *not* provide that all of the amount received shall be treated as capital gains; it does *not* in any way modify or qualify the rule that amounts received on the sale or exchange of a capital asset that represent ordinary income are taxable as ordinary income, not as capital gain.

The legislative history confirms this construction of Section 117(f). At the hearings on the 1934 Act, the spokesman for the Tax Committee of the American Bar Association recommending the change simply urged that Congress should decide whether retirement of bonds should be treated as a sale or exchange. House Hearings, Revenue Act of 1934, pp. 179-181, 191. The Committee Report (H. Rep. No. 704, 73d Cong., 2d Sess., p. 31 (1939-1 Cum. Bull. (Part 2) 554, 557) restates the text of the provision as follows:

> 8. Subsection (f) provides that amounts received upon the retirement of corporate bonds and similar evidences of indebtedness shall be considered as amounts received in exchange therefor.

It follows therefore that Section 117(f) was not intended to, and by its terms does not, convert ordi-

nary interest income received upon maturity of an investment into capital gain, since the addition of this subsection was purposed to treat transactions involving retirement of evidences of indebtednesses in the same fashion, so far as application of capital rates is concerned, as sales or exchanges. The purpose was not to impose a lesser tax in their case nor to include ordinary income in the scope of the capital transaction, when it would not be so included in the case of a sale or exchange.

What Congress had in mind in the enactment of Section 117(f) plainly was the purchase of a bond at a price below the amount received upon its retirement, apart from any interest or accrued increment or original interest discount.

Section 117(f) is to be read in the light of the decision of this Court in *Fairbanks* v. *United States*, 95 F. 2d 794, affirmed, 306 U.S. 436, construing the 1926 and 1928 Revenue Acts. As the record in *Fairbanks* shows, the taxpayer acquired corporate bonds of an aggregate par value of $4,000,000 for property valued at $1,096,445.42. (Record on appeal in this Court, No. 8444, p. 60.) Later, a number of the bonds of an aggregate par value of $1,900,000 were retired at par value by the corporation. This Court held that a redemption was not a sale or exchange to which capital gains on the conversion of capital assets were confined by the 1926 and 1928 Revenue Acts. The *Fairbanks* bonds also paid interest, and all accrued interest was also payable on redemption, but no interest payments were involved in the case. (See R. No. 8444, p. 60-61.)

Accordingly it is submitted with respect that *Commissioner* v. *Caulkins, supra*, represents a misinterpretation of the meaning of Section 117(f) and should not be followed. In the *Caulkins* case the Sixth Circuit held (p. 484) that the amount received upon the retirement of a certificate, substantially the same as the certificate here involved, included interest, but erroneously, as we view it, approved the taxation of this interest at capital rates. Yet, as already seen, subsequently in *Fisher* v. *Commissioner, supra*, in the case of the sale of notes the same court held that since the sale price reflected interest due on the notes, the taxpayer must treat his right to this ordinary income as ordinary income, notwithstanding that the right to it was transferred in the course of a sale of the capital asset. The analysis of the Fisher decision by this Court in *United States* v. *Snow, supra*, has already been quoted; for convenience, it is in part repeated here:

> In the *Fisher* case the court pointed out that the fundamental error of the taxpayer was his failure to recognize that gain realized upon the sale of a capital asset which has appreciated in value is capital gain; whereas, gain realized by way of income from the capital asset is ordinary income. (223 F. 2d, *supra*, p. 109.)

It is submitted that in Section 117(f) and its 1954 Code cognate Section 1232(a)-1 Congress intended to express the same, not a different rule. It is here significant that in the *Fisher* case the court noted that the interest would have been taxable income as it came due if taxpayer there had been on the accrual

basis (209 F. 2d., p. 515). See also, *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; *Dally* v. *Commissioner*, 227 F. 2d 724 (C.A. 9th).

Indeed, as stated by Mertens (3B Mertens, Law of Federal Income Taxation, Sec. 22.40, p. 185), "ultimate rejection of the *Caulkins* case appears to be portended by the trend of recent decisions." [4] To the same effect, see also 3B Mertens, Law of Federal Income Taxation, Sec. 22.94, pp. 379-380.

While for some years the Commissioner acquiesced in the *Caulkins* decision (1944 Cum. Bull. 5), namely, from December 25, 1944, to December 31, 1954, thereafter he expressly withdrew his acquiescence. In Rev. Rul. 119, 1953-2 Cum. Bull. 95, the Commissioner ruled that the discount interest on Israeli bonds payable as cash value or on maturity was ordinary income and confined *Caulkins* to its precise facts. And in Rev. Rul. 56-299, 1956-1 Cum. Bull. 603 (republishing Rev. Rul. 55-136, 1955-1 Cum. Bull. 213), the Commissioner withdrew his acquiescence in *Caulkins*. The Supreme Court has only recently sustained the authority of the Commissioner to correct a mistake of law. *Automobile Club* v. *Commissioner*, 353 U.S. 180. Taxpayer is in no way prejudiced by the Commissioner's action, since he purchased the investment certificates in 1937 (R. 29) before the *Caulkins* decision in 1944 and the Com-

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[4] See, e.g., *Shattuck* v. *Commissioner*, 25 T.C. 416, 423; *Tobey* v. *Commissioner*, 26 T.C. 610; *Paine* v. *Commissioner*, 23 T.C. 391, 401, reversed on other grounds, 236 F. 2d 398 (C.A. 8th), and other authorities since *Caulkins* discussed *supra*.

missioner's subsequent acquiescence and withdrawal of acquiescence.[5] As Mertens further states, referring to these rulings and the cases above cited (3B Mertens, *supra*, Sec. 22.40, pp. 185-186):

> These recent decisions reflect a campaign of constant attrition which the Commissioner has waged against the Caulkins case. It resulted, upon the enactment of the 1954 Code, in the inclusion of new provisions which deal with "original issue discount" and attempt to separate the interest element from the capital gain element.[6]

Nor is there any basis for a claim of Congressional ratification of the *Caulkins* decision. Indeed, in recommending the new provision the Senate Committee indicated that the prior law was uncertain,

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[5] Thus Rev. Rul. 56-299 (1956-1 Cum. Bull. 603, 604) provides:

> Pursuant to the authority contained in section 3791(b) of the Internal Revenue Code of 1939, the provisions of this Revenue Ruling will be applied without retroactive effect to any amounts received upon redemption of Accumulative Installment Certificates purchased during the period beginning December 25, 1944, (the date the acquiescence in the Caulkins case was announced) and ending December 31, 1954.

[6] The new statutory provisions enacted by the 1954 Code applies to evidences of indebtedness issued after December 31, 1954. Section 1232(a)(2). However, as already stated, for the taxable year 1954 the Code continues in substance the statutory language contained in Section 117(f) of the 1939 Code. See S. Rep. No. 1622, 83d Cong., 2d Sess. p. 433, 3 U.S.C. Cong. & Adm. News (1954) p. 5076. See Section 1232(a)(1) of the 1954 Code, *supra*. Moreover, a "face-amount certificate" issued after December 31, 1954, on retirement is treated specially. Section 1232(d) and 72(l) of the 1954 Code.

citing explicitly the *Caulkins* case, and that it understood that it was removing doubt in this area rather than changing the existing law;[7] in effect it was left to the courts to settle the question as to evidences of indebtedness issued before January 1, 1954.

It is submitted that the plain meaning of the governing statutory provisions and the later decisions of the courts indicate that the result reached in *Caulkins* does not accord with the weight of judicial authority or with correct principle and that ordinary interest income is taxable as such, whether received or accrued on a sale, exchange or retirement or as here in the case of an accrual taxpayer upon the

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[7] S. Rep. No. 1622, 83d Cong., 2d Sess., p. 112 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4745):

> Under section 117(f) of present law, when a corporate or Government bond in registered form or with coupons attached is retired the transaction is treated as a sale or exchange. There is some uncertainty as to the status of proceeds in these transactions, i.e., as capital gain or as interest income where the bond or other evidence of indebtedness has been issued at a discount (see I.T. 3486, 1941-2, C. B. p. 76, as compared with *Comm.* v. *Caulkins,* 144 F. 2d 482). In these cases, that part of of the amount received on a sale or exchange which may representa partial recovery of discount on original issue is a form of interest income and in fact is deductible as an interest payment by the issuing corporation.
>
> Effective with respect to bonds issued after December 31, 1954, the House bill removes doubt in this area by providing that any gain realized by the holder of a bond attributable to the original issue discount will be taxed as ordinary income. This is, of course, not intended to have any effect with respect to bonds issued before that date.

accrual of the annual interest increment in the excess of cash value of the certificate over the amounts paid in.

CONCLUSION

The decision of the Tax Court with respect to the issue of the "Accumulated Investment Certificate" is erroneous and should be reversed, and the case remanded to the Tax Court for a determination of the income tax deficiency resulting from the taxation of the annual increment of cash value as ordinary income of the taxpayers for the years 1950 through 1954.

Respectfully submitted,

CHARLES K. RICE,
Assistant Attorney General.

LEE A. JACKSON,
I. HENRY KUTZ,
JOSEPH KOVNER,
Attorneys,
Department of Justice,
Washington 25, D. C.

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